UNIVERSITI PUTRA MALAYSIA

PERFORMANCE OF INITIAL PUBLIC OFFERINGS OF GOVERNMENT LINKED AND PRIVATE COMPANIES IN MALAYSIA

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By

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Abstract of thesis presented to the Senate of Universiti Putra Malaysia in partial fulfilment of the requirements for the degree of Master of Science

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Chairman: Professor Shamsher Mohamad Ramadili, Ph.D.

Faculty: Graduate School of Management

This study examined the relative performance of Government-linked Initial Public Offerings (GLIPOs) and Private Initial Public Offerings (IPOs) during 1984 to 2002 based on a sample of 74 newly listed companies on the Kuala Lumpur Stock Exchange. The overall results consistent with previous studies indicate that most IPOs are generally underpriced on their first day of trading. On average GLIPOs are more underpriced than private IPOs but the difference is not statistically significant.

Short and long run performances reveals that only investors that are fortunate to be allocated with new issues at the offer price are able to gain positive return. IPOs become unfavourable investment if the new shares are bought at the aftermarket price. Both short and long run performances show that there is no significant difference between GLIPOs and private IPOs.

The evidence shows that GLIPOs performed better than private IPOs before the economic crisis period when market was booming and performed lower than private IPOs in post crisis. As far the GLIPOs, there was no significant difference between federal-owned and state-owned IPOs. The performance of both GLIPOs and private

IPOs based on business sectors showed no significant difference in performance, except for trading and service sector where GLIPOs performed better than private IPOs.

A further analysis based on firms' characteristics reveals that market volatility, *ex ante* risk, debt ratio, profitability ratio, asset management ratio and size of the firm together explained 38 percent of the variation in the excess returns offered by GLIPOs. However, the model explained 40 percent for private IPOs.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi sebahagian keperluan untuk ijazah Master Sains

PRESTASI TERBITAN SAHAM BARU SYARIKAT KERAJAAN DAN SYARIKAT SWASTA DI MALAYSIA

Oleh

NORZALINA BINTI AHMAD

November 2003

Pengerusi: **Profesor Shamsher Mohamad Ramadili, Ph.D.**

Fakulti: **Sekolah Pengajian Siswazah Pengurusan**

Penyelidikan ini bertujuan untuk mengkaji perbandingan prestasi di antara terbitan saham baru syarikat kerajaan dan terbitan saham baru syarikat swasta bagi tempoh 1984 sehingga 2002 berdasarkan sampel sebanyak 74 buah syarikat yang baru disenaraikan di Bursa Saham Kuala Lumpur. Hasil kajian menunjukkan, keputusan yang selari dengan keputusan kajian yang lepas di mana terbitan saham baru telah ditawarkan pada harga yang lebih rendah daripada harga yang sebenarnya pada hari pertama penyenaraian. Secara puratanya, pulangan bagi terbitan saham baru syarikat kerajaan adalah lebih tinggi daripada pulangan terbitan saham baru syarikat swasta, tetapi perbezaan ini adalah tidak signifikan.

Analisis bagi jangka masa pendek dan jangka masa panjang menunjukkan pelabur yang dapat membeli terbitan saham baru pada harga terbitan akan memperoleh keuntungan. Terbitan saham baru juga merupakan pelaburan yang tidak menguntungkan sekiranya dibeli pada harga selepas ianya disenaraikan. Prestasi jangka masa pendek dan jangka masa panjang pula menunjukkan tiada perbezaan pulangan bagi terbitan saham baru syarikat kerajaan dan terbitan saham baru syarikat swasta.

Terdapat bukti yang menunjukkan terbitan saham baru syarikat kerajaan menawarkan pulangan yang lebih banyak berbanding terbitan saham baru syarikat swasta sebelum bermulanya krisis ekonomi atau semasa pasaran sedang meningkat dan pulangan yang sedikit selepas krisis ekonomi. Bagi terbitan saham baru syarikat kerajaan, tiada perbezaan yang signifikan di antara terbitan saham baru milik kerajaan persekutuan dan terbitan saham baru milik kerajaan negeri. Prestasi bagi kedua-dua terbitan saham baru syarikat kerajaan dan syarikat swasta adalah tidak berbeza bagi sektor-sektor perniagaan kecuali bagi sektor barangan dan perkhidmatan di mana prestasi terbitan saham baru syarikat kerajaan adalah lebih baik berbanding syarikat swasta.

Analisis seterusnya yang lebih memberi penekanan kepada faktor-faktor syarikat menunjukkan kemudahubahan pasaran, risiko *ex ante,* nisbah hutang, nisbah keuntungan, nisbah pengurusan aset dan saiz syarikat menerangkan 38 peratus terhadap perbezaan lebihan keuntungan yang ditawarkan oleh terbitan saham baru syarikat kerajaan. Walaubagaimanapun, model ini menerangkan 40 peratus terhadap perbezaan pulangan yang ditawarkan oleh terbitan saham baru bagi syarikat swasta.

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Last but most, I wish to express my sincere appreciation to my father, Ahmad Jusoh and my mother, Aishah Abdullah and also the rest of my family for their unconditional love and patience. Their never fading confidence and support in me has become my ultimate motivation in making this thesis possible.

I certify that an Examination Committee met on **16 September 2003** to conduct the final examination of **Norzalina binti Ahmad** on her **Master of Science** thesis entitled **"Performance of Initial Public Offerings of Government-linked and Private Companies in Malaysia"** in accordance with Universiti Pertanian Malaysia (Higher Degree) Act 1980 and Universiti Pertanian Malaysia (Higher Degree) Regulations 1981. The Committee recommends that the candidate be awarded the relevant degree. Members of the Examination Committee are as follows:

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DECLARATION

I hereby declare that the thesis is based on my original work except for quotations and citations which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at UPM or other institutions.

NORZALINA AHMAD

Date: 16/11/03

TABLE OF CONTENTS

LIST OF TABLES

LIST OF ABBREVIATIONS

BO	Build-operate-own
BOT	Build-operate-transfer
BT	Builds transfer
CoV	Coefficient of Variation
ESOP	Employees Share Ownership Plan
FIC	Foreign Investment Committee
GLIPOs	Government-linked Initial Public Offerings
IPOs	Initial Public Offerings
KLSE	Kuala Lumpur Stock Exchange
MAIR	Market-adjusted Initial Returns
MITI	Ministry of International Trade and Industry
PIPO	Privatization Initial Public Offering
SC	Securities Commission
SIPs	Share Issue Privatizations

CHAPTER ONE

INTRODUCTION

This chapter discusses the background of the study and also the background of Malaysian privatisation programme. It further explains the impact of privatisation on the Malaysian capital market. Information about the initial public offerings is also included. Finally, the problem statement, the objectives of the study and the significance of the study will be discussed.

1.1 Background of the Study

Since the 1980s, some of the major countries namely the United Kingdom, France, Brazil, Chile, Mexico, most Eastern European countries and Malaysia adopt the policy of privatisation. The primary argument for privatisation rests on the assumption that the management and control of enterprises in the hands of the private sector will be superior to that in the public sector and resources would be utilized more efficiently. The most popular form of raising share capital in the privatisation programme is through public offerings. The public benefits from the newly listed privatised companies in terms of capital appreciation, as the share prices are higher than their initial offer prices (underpricing). For financial analysts, this recent wave of privatisation has raised several interesting issues such as long-term versus short-term performance of privatised firms relative to their private counterparts.

The issue of Initial Public Offerings (IPOs) underpricing has gained considerable attention among academics, practitioners and policy makers due to its strategic impact on investment decision and asset allocation. The average underpricing of IPOs varies across different markets. The findings by Shamsher, Annuar and Ariff (1994) showed that average underpricing in Malaysia is far higher than those in many other developed and developing countries. It was found that Malaysian IPOs do not underperform the market benchmark in aftermarket trading over the long run (Dawson, 1987; Shamsher *et al.*, 1994).

The rich and fast growing literature on IPOs incorporates privatised companies as well as private companies. However, there is scarcity of published evidence concerning the underpricing of Government-linked Initial Public Offerings (GLIPOs) in Malaysia. The tremendous changes that have taken place in the Malaysian market such as the financial crisis in 1997 affect share price behaviour. In view of this, in addition to the coverage of an increased sample size and longer time horizon, this study addresses the issues related to the relative performance of GLIPOs and private IPOs in Malaysia.

1.2 The Importance and Development of Capital Market

Capital market plays an important role in the economic development of a country since a capital market provides unparalleled access to the medium and long-term funds for economic growth. The business community and the government can both obtain the needed funds by selling securities in the capital market. At the same time, investors with excess funds can invest in the capital market by buying those securities. This shows that the capital market acts as a financial intermediary between those who want to earn extra returns and are willing to take some risks by investing and those who need funds to meet their business requirements. There are basically two ways for a company or government to raise capital to finance its business. One way is through debt financing, which is borrowing money from financial institutions or issuing bonds. Another way is through equity financing, which is selling the company's shares.

The recent decade has witnessed a tremendous growth in the capital markets of Malaysia. In keeping up with the spirit of corporatisation, the total number of listed companies on KLSE rose from 285 in 1990 to 793 in 2000. The market capitalisation recorded a growth of RM362 billion during the period of 1990 to 2000. With globalisation and privatisation, the capital market has taken a dynamic shape in Malaysia's economy. The successful privatisation of Telekom Malaysia and Tenaga Nasional, has each increased the market capitalisation of KLSE by more than 10 percent at the time of their respective initial public offerings. It also provides ample evidence of receptiveness of domestic and foreign investors towards the quality of the Malaysian capital market. The 1997 Asian crisis had however shocked the Malaysian capital market. The numbers of newly listed companies in 1990, 1994 and 1997 stood at 31, 66 and 88 respectively. The economic crisis had reduced the numbers of newly listed companies in 1998, 1999 and 2000 to 28, 21 and 36 respectively. The yearly capital market mobilization went down to RM5,446.2 million in 2000 from RM19,116.5 million in 1997.

Table 1 : Funds Raised in the Malaysian Capital Market (1996-2001)

Sector	1996	1997	1998	1999	2000p	2001
	RM Million					
BY PUBLIC SECTOR						
Debs Securities						
Malaysian Government Securities (MGS)	6,000.0	3,000.0	14,950.0	10,000.0	16,413.5	23,086.9
Khazanah Bonds (KB)		794.4	2,731.9	2,598.2	1,550.7	1,630.4
Government Investment Issues (GII)				2,000.0	2,000.0	1,805.5
Malaysian Saving Bonds (MSB)				377.2	-	-
New Issues of Debt Securities Issues	6,000.0	3,794.4	17,681.9	14,975.4	19,964.2	26,522.8
Less : Redemptions						
MGS	3,809.0	3,648.0	6,200.0	6,676.0	5,285.7	7,100.0
KB	-	-	-	-	1,000.0	1,850.0
GII	900.0	1,400.0	750.0	2,000.0	-	2,000.0
MSB	34.0	154.8	928.2	2.1	19.2	358.5
Less : Government Holdings	(74.1)	(1.2)	-	-	-	-
Net Funds Raised by the Public Sector	**1,331.1**	**(1,407.2)**	**9,803.7**	**6,297.3**	**13,659.2**	**15,214.3**
BY PRIVATE SECTOR						
Shares/Warrants						
Ordinary Shares						
Initial Public Offers (IPOs)	4,099.2	4,781.0	684.6	1,009.2	992.3	1,677.9
Right Issues	5,268.5	8,524.9	722.0	4,346.9	3,898.5	1,892.0
Private Placement/Restricted Offer-for-Sale	4,554.4	3,233.6	320.1	518.6	912.0	1,680.5
Special Issues	2,002.3	1,818.8	61.0	208.0	126.1	32.9
Warrants				13.5	84.3	840.3
New Issues of Shares/ Warrants	15,924.4	18,358.3	1,787.7	6,096.2	6,013.1	6,123.6
Debt Securities						
Straight Bonds	2,675.4	4,209.0	10,238.0	18,182.0	12,940.0	13,812.8
Bonds with Warrants	5,563.7	2,950.3	150.0	947.4		912.8
Convertible Bonds	1,794.6	3,062.4	98.8	1,269.2	1,943.7	1,328.0
Islamic Bonds	2,350.0	5,249.7	345.0	1,734.0	7,666.1	13,307.3
Asset Backed Bonds						1,235.4
Cagamas Bonds	4,665.0	5,169.0	3,320.0	4,425.0	8,547.0	6,430.0
New Issues of Debt Securities	17,048.7	20,640.4	14,151.8	26,557.6	31,096.8	37,026.3
Less: Redemptions						
Private Debt Securities	1,765.0	1,368.5	2,964.4	6,279.5	6,205.2	15,575.0
Cagamas Bonds	750.0	1,640.0	5,012.0	6,470.0	4,254.0	5,315.0
Net Issues of Debt Securities	14,533.7	17,631.9	6,175.4	13,808.1	20,637.6	16,136.3
Net Funds Raised by the Private Sector	**30,458.1**	**35,990.2**	**7,963.1**	**19,904.3**	**26,650.7**	**22,259.6**
Net Funds Raised in the Capital Market	31,789.2	34,583.0	17,766.8	26,201.6	40,309.9	37,473.9

(Source: Bank Negara Malaysia, http:// www.bnm.gov.my)

Table 1 presents the distribution of funds raised in the Malaysian capital market during 1996–2001. The table indicates that half of the total fund raised by the private sector came from new issues of shares in 1996 and 1997. However, the fund declined significantly due to the effects of the Asian economic crisis. The biggest contributions in the equity market were from initial public offers and rights issues, with IPOs playing an important role in contributing to the capital market development.

1.3 Privatisation in Malaysia

In the Malaysian context, privatisation is defined as the transfer to the private sector of activities and functions, which have traditionally rested with the public sector. Therefore, privatisation involves two distinct parties dealing in business with each other, namely the government and the private sector. To promote the growth of privatisation, a conducive environment essential to its development must be present in both the public and private sectors. The most vital condition is the presence of a well-developed private sector. A country will not be able to emulate the successful privatisation experience of others if it does not have a well-established private sector supported by a conducive investment climate, which in turn will attract investment in privatised companies.

Privatisation was introduced in Malaysia in 1983 at a time when public debt was increasing, government's involvement in economic activities were becoming too extensive, government-owned companies were losing money and the number of public sector employees was increasing. The policy became a major impetus towards promoting the private sector as the engine of growth in the development process. It was based on the premise that the transfer to the private sector of activities and functions, which had traditionally rested with the government, would bring about positive changes in the organisation, management and performance of public enterprises.

In Malaysia, privatisation covers a broad scope, which includes state-owned enterprises and companies, as well as new projects such as construction projecfs in the infrastructure, utilities and energy sectors. In terms of modes of privatisation, apart from divestment of state-owned enterprises, Malaysia has adopted other modes including the build-operate-transfer (BOT), build-operate-own (BO) and builds transfer (BT), which is utilized for new projects. Privatisation now forms one of the important instruments of the government economic programme towards achieving the national vision of a fully developed nation by the year 2020.

Privatisation can also play a vital role in the achievement of the stipulated policy objectives of the government, particularly with respect to the policy aimed at achieving equitable wealth distribution in a country. In the case of Malaysia, the objective of wealth distribution is to increase bumiputra participation in the corporate sector. Hence, privatisation forms an integral part of the government's strategy in realizing this objective. The programme therefore has been used as a vehicle to correct the imbalance in the corporate sector by providing wider opportunities for bumiputra to participate in the privatisation of government companies. Towards this end, as a matter of policy, a provision has been made for all privatised projects to have at least 30 percent bumiputra participation.

1.4 Objectives of Privatisation

The objectives of privatisation programme in Malaysia are as follows:

1. Relieving financial and administrative burdens of the government.

A significant development in Malaysia increases the size of public deficit. The government has to finance development and operating expenditure by borrowing especially from foreign sources. This will increase the total outstanding debt service charge. Appropriate measures such as privatisation need to be implemented to overcome this constraint. The sale of government-owned assets and shares can generate proceeds and can also reduce the government's expenditure.

2. Promoting competition, raising efficiency and productivity.

Privatisation promotes competition in the industry. This plays an important role in introducing modern technology, particularly in sectors involving large capital investment, thereby leading to increased efficiency and productivity of privatised entities.

3. Accelerating growth through privatisation.

Privatisation plays an important role in accelerating economic growth in at least three ways as privatised entities are profit motivated and are more flexible to pursue corporate expansion goals. Firstly, the efficiency gain as a result of privatisation leads to growth as more output is produced using less resources. Secondly, resources that are released as a result of efficiency gains are being utilized for further corporate expansion. Thirdly, growth is generated in a more direct manner through various BOT/BO projects and land development projects that encourage private sector entrepreneurs to invest in sectors which previously are the domains of public sector.

4. Reducing the size and presence of the public sector in the economy.

The traditional areas of public involvement include defense and internal security, the provision of education and health facilities, water, electricity, sewerage, roads, railways, ports and airports. The cost of providing and maintaining these traditional services has been very high. Through privatisation, the private sector can access these areas and participate more actively,thus providing better quality services.

5. Privatisation and opportunities for meeting the targets of the New Economic Policy (NEP).

Privatisation can enhance the growth prospects of private entities and therefore provide substantial opportunities for achieving further progress towards the objectives of the NEP, most importantly by restructuring the ownership pattern of the economy and making further progress towards achieving the 30 percent bumiputra ownership target of the share capital in the corporate sector.

1.5 The Impact of Privatization on the Capital Market

The most popular form of raising share capital in the privatisation programme is through public offerings. This has proven to be a popular way of attracting a wider range of people to benefit from the privatised issues. The objective of achieving widespread share ownership among the general population is especially relevant in the privatisation of government entities because of their sizes and operations, which affect the overall population. Public offerings can also provide a wider range of opportunities from the privatisation programme.

Since the mid 80's, successful flotation of shares of several privatised entities in the KLSE has had a good response from the public. It has boosted the domestic securities industry in terms of the number of stocks as well as introduced new sectors and thus increased market capitalisation. The effectiveness of the government's privatisation policy has contributed to increased capitalisation of financial markets in Malaysia. At the same time the capital market has played an important role in mobilizing resources, both domestic and foreign, to enable successful flotation of privatised enterprises. Public flotation of privatised companies has resulted in the widening of share ownership through allocation of shares to small investors and employees, for example, through the Employees Share Ownership Plan (ESOP).

Privatisation has contributed significantly to the development of the capital market. In 1992, it has resulted in an increase of the KLSE equity fund which was attributed mainly to the government's effort in the privatisation of its major enterprises, such as PROTON, Tenaga Nasional Berhad (TNB) and the rights issue of Malaysian Airlines System (MAS). TNB's offer of 685 million shares totalling RM3.2 billion in 1992 is the biggest public issue on KLSE, exceeding the flotation of Telekom Malaysia Berhad (TMB) in 1990, which issued 470.5 million shares valued at RM2.4 billion.

The generally strong demand for Malaysian securities from domestic and foreign sources is being initiated by the listings and performance of the new and existing companies in the stock market. The companies listed represent strong companies in addition to a wider choice of investment alternatives, especially arising from the privatisation efforts of the government. The impact of privatisation of strong companies has deepened and broadened the flow of investments, as it offers a wide opportunity for both foreign and domestic investors to invest in quality stocks. The participation of foreign institutional investors has contributed to the significant increase in liquidity, as well as enhancing the strength and stability of the capital market. In addition, the privatisation programme has placed strong demands on the capital markets, due to privatisation of fresh equity issues as well as from subsequent offering of equity issues and raising of loans by existing companies to finance the purchase of privatised companies.

The listing of privatised companies on the KLSE enables a wider distribution of equity ownership to the public. A total of 40 privatised companies were listed on the KLSE, of which 16 were listed during 1996-1999. Of the new listing, the Malaysian public was allocated 939.4 million shares (81 percent), while approved bumiputra investors or institutions were allocated 159.1 million shares (13.7 percent). The listing of privatised companies on the KLSE contributed RM131.1 billion or 30.3 percent of the total market capitalisation as of December 2000. These privatised companies constituted only 5.0 percent of the total listed companies. The shares of listed privatised companies were relatively less affected by the financial crisis, as reflected by their market capitalisation, which increased from about 20 percent before the crisis to 29.4 percent as of 31 December 1997. This was attributed mainly to secure investments of these companies, which provided reasonable returns to their investors. The public also benefited from the newly listed privatised companies in terms of capital appreciation, as the share prices were higher than their initial offer prices.

1.6 Initial Public Offering

In the early stages of development, new private enterprises issue and sell stock to raise capital for expansion and growth. With the increased speed at which business operates today, small private companies must obtain large amounts of capital quickly in order to compete. To raise these huge sums, a company sells ownership positions in the form of equity stock or debt bonds. A stock is an equity investment that represents partial ownership in a company. A bond is an equity investment that represents ownership of a portion of debt to be repaid with interest to the bondholder by the company. Although requiring capital to support future expansion and growth is the primary reason that companies go public, this may or may not mean that the funds raised will be used to build a new factory, hire more staff or support on-going research and innovation. The company is free to use the capital as it sees fit. Often some of the money is used to pay off outstanding debts.

To seek listing on the KLSE, a company has to offer its securities for sale to the investing public through three recognized methods which are new public issues, offers for sale and a combination of the two. A new public issue involves the creation of additional shares being offered to the public. However in an offer for sale, existing owners offer a portion of their shareholdings to the public and then collect the proceeds, which results in no additional capital injection for the company.